

STATE CORPORATION COMMISSION

AT RICHMOND, AUGUST 9, 2007

DOCUMENT CONTROL

APPLICATION OF

APPALACHIAN POWER COMPANY

CASE NO. PUE-2007-00068-18

For a Rate Adjustment Clause
Pursuant to § 56-585.1 A 6
of the Code of Virginia

ORDER FOR NOTICE AND HEARING

On July 16, 2007, Appalachian Power Company ("Appalachian" or "Company") filed with the State Corporation Commission ("Commission") an Application seeking approval of a rate adjustment clause for recovery of costs the Company proposes to incur in conjunction with its planned construction of an Integrated Gasification Combined Cycle ("IGCC") electric generating facility to be sited in Mason County, West Virginia, adjacent to Appalachian's Mountaineer Generating Station. The projected cost of this IGCC facility is \$2.23 billion, of which approximately \$1 billion is proposed to be allocated to Appalachian's Virginia customers. The investment will increase the net book value of Appalachian's utility assets by more than 55 percent, from approximately \$3.8 billion to nearly \$6.0 billion. The principal relief sought in this Application is Commission approval of the rate adjustment clause requested by the Company, and a Commission determination that "construction of the IGCC facility is reasonable and prudent." Application at 1, 2.

The Company cites subdivision A 6 of Virginia Code § 56-585.1, enacted by the 2007 Session of the Virginia General Assembly, as authority for the proposed rate adjustment clause. This new statute, *inter alia*, permits utilities such as Appalachian to request recovery, in conjunction with the construction of coal-fueled electric generating facilities, of the financial carrying costs of projected construction work in progress ("CWIP") together with an allowance

for funds used during construction prior to the commercial operation date of such facilities through a rate adjustment clause.

According to testimony submitted in support of the Application, the rate surcharge proposed in this Application is designed to collect "IGCC financial carrying charges incurred and deferred between July 1, 2007 and December 31, 2008."¹ Additionally, the Company is seeking in this proceeding to establish a rate surcharge collecting "IGCC carrying costs for the year 2009 as they are incurred by the Company."² In sum, the Company is seeking to establish this surcharge based upon carrying charges estimated for the 30-month period beginning July 1, 2007 through December 31, 2009.

The rate surcharge proposed in the Application, if approved, will become effective and be applied to customer bills on the later of 60 days following the Commission's final order herein or upon the expiration or termination of capped rates,³ as set forth in § 56-585.1 A 8. The Application also states the Company's intentions to seek, in subsequent proceedings, adjustments or "true-ups" to any surcharge approved by the Commission in this proceeding. Such adjustments will, according to the Application, "reflect future IGCC financial carrying costs, the true-up of any over/under recoveries of prior periods and the recovery of capital and operational expenses of the plant when it is placed in service."⁴

Significant to the current Application, Subdivision A 6 of § 56-585.1 establishes "as an incentive to undertake such projects, an enhanced rate of return" for certain types of electric

¹ Direct Testimony of Company witness, Larry C. Foust, at 2, 3.

² Id. at 3.

³ Amendments to § 56-582 of the Code made by the 2007 Session of the Virginia General Assembly (SB 1416) terminate the capped rate period on December 31, 2008.

⁴ Direct Testimony of Company witness, Larry C. Foust, at 3.

generation facilities proposed for construction, including "carbon capture compatible, clean-coal powered" electric generation facilities. Appalachian asserts that the proposed IGCC plant is a "carbon capture compatible, clean-coal powered" generation facility, and thus qualifies for the 200 basis point, statutory rate of return incentive enhancement authorized by subdivision A 6 of § 56-585.1 for the first portion of the IGCC facility's expected service life.

Specifically, the Company has proposed a general rate of return on common equity capital for the proposed IGCC facility of 12%, plus a 2% (200 basis points) incentive enhancement for a total equity return of 14%⁵ to be realized by the Company (i) during construction of the IGCC facility, and (ii) during the first portion of this facility's service life which the Company asserts should be determined to be 20 years. Application at 3.

The Company estimates that its Virginia customers' allocated share of the financial carrying charges associated with the IGCC plant's construction expenditures for the 30-month period commencing July 1, 2007, and ending December 31, 2009, will approximate \$45 million.⁶ Appalachian has proposed to recover this sum in calendar year 2009, by instituting an IGCC surcharge ("IGCCS") factor to be applied to customers' bills starting on January 1, 2009. The IGCCS⁷ factor proposed for this period is 10.7078%, to be multiplied against the generation portion of its Virginia retail customers' electric bills. According to the Company, this is

⁵ The Commission would observe that the detailed provisions of newly-enacted § 56-585.1 A 6 that govern this proceeding require this Commission to establish a general rate of return for this facility that will remain in effect for the construction phase of the project and the entire service life of the facility. Moreover, if the Commission approves the 200 basis point performance incentive requested by the Company, § 56-585.1 A 6 explicitly prohibits any change thereafter.

⁶ Testimony of Company witness, Larry Foust, at 3, 4, and Schedule 1 attached thereto.

⁷ The Company calculated its proposed IGCCS factor by dividing the estimate of IGCC financial carrying charges on the construction expenditures for the period 7/1/07 through 12/31/09 (allocated to Virginia customers) by the Company's 2009 forecasted, Virginia-jurisdictional generation revenues, excluding fuel and riders. Testimony of Company witness, Larry Foust, at 4.

estimated to result in a total bill increase of 4.8% (utilizing 2007 as a base) for Appalachian's Virginia customers in 2009. The Company further estimates that the IGCCS factor will continue to increase through the first year of the proposed plant's operation (projected in the Application as 2012), such that the total bill increase at that time is estimated to be 13.3% (utilizing 2007 as a base).⁸

Supporting testimony accompanying the Application acknowledges, however, that the proposed IGCCS factor is based solely on projections of CWIP through the end of 2009, and that actual CWIP expenditures are likely to deviate (higher or lower) from these projections.⁹ The Company has, therefore, offered to provide, late in 2008, updated actual and projected data for the purposes of recalculating the IGCCS factor to reflect a mix of actual CWIP for the period July 1, 2007 through December 31, 2008, and updated projections of 2009 CWIP expenditures.¹⁰

The Company has stated that it intends this Application to "request all Commission approval necessary to implement the rate adjustment clause sought herein, including any and all approvals necessary for the Company to make the expenditures necessary to construct its proposed IGCC facility." Application at 4.

NOW UPON CONSIDERATION of the Application and applicable law, the Commission is of the opinion and finds as follows.

This matter shall be docketed, a procedural schedule shall be established, and Appalachian shall give notice of its Application, all as prescribed below.

⁸ Testimony of Company witness, Larry Foust, at 4.

⁹ Testimony of Company witness, Philip J. Nelson, at 5.

¹⁰ Id. at 6.

The Commission notes that newly-enacted § 56-585.1 A 6 requires the Commission's review of the rate adjustment clause proposed herein in the larger context of the Virginia General Assembly's explicit goal to "ensure a reliable and adequate supply of electricity, to meet the utility's projected native load obligations and to promote economic development."

Additionally, § 56-585.1 D authorizes the Commission to determine the reasonableness or prudence of costs incurred or projected to be incurred by the Company in connection with the proposed coal-fired generating facility, consistent with the provisions of Chapter 10 of Title 56, § 56-232 *et seq.* of the Code. In this regard, § 56-234.3 of the Code has long guided this Commission in determining the reasonableness of jurisdictional utilities' proposed construction of new generating facilities having 100 MW or greater of capacity.

Section 56-234.3 requires the Commission to find that generation facilities proposed for construction are "necessary to enable the public utility to furnish reasonably adequate service and facilities at reasonable and just rates." We will, therefore, direct the Company to (i) supplement its application to the extent necessary to enable review of the costs the Company proposes to incur in connection with this project under § 56-234.3 of the Code, or (ii) file a memorandum explaining why the Company does not believe such supplementation is needed.

The Commission further observes that newly enacted § 56-585.1 A 7 requires the Commission to enter an Order concerning this Application within nine months following the date on which the Application was filed (July 16, 2007).

Accordingly, IT IS ORDERED THAT:

(1) The Company's Application is hereby docketed and assigned Case No. PUE-2007-00068.

(2) A copy of the Application and this Order for Notice and Hearing, as well as other documents now or hereafter filed in this matter, shall be available for public inspection in the Commission's Document Control Center located on the First Floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia, between the hours of 8:15 a.m. and 5:00 p.m., Monday through Friday. A copy of the Application also may be obtained by requesting a copy of the same from counsel for Appalachian, Anthony Gambardella, Esquire, Woods Rogers PLC, 823 East Main Street, Suite 1200, Richmond, Virginia 23219. Upon receipt of a request for a copy of the Application, the Company shall serve copies of the same upon the requesting party within three (3) business days of such request. If acceptable to the requesting party, the Company may provide the Application, with or without attachments, by electronic means. In addition, the Commission's Order For Notice and Hearing and other orders entered in these dockets, the Commission's Rules of Practice and Procedure, as well as other information concerning the Commission and the statutes it administers, may be viewed on the Commission's website at <http://www.scc.virginia.gov>.

(3) On or before September 5, 2007, the Company shall (i) supplement its Application to the extent necessary to enable review of the costs the Company proposes to incur in connection with this project under § 56-234.3 of the Code or (ii) file a memorandum explaining why the Company does not believe such supplementation is needed. In the event that the Company files such a memorandum, any interested party or the Staff may file a memorandum in response thereto on or before September 26, 2007. The Company may reply to any such responding memoranda on or before October 3, 2007.

(3) A public hearing shall be convened on February 12, 2008, at 10:00 a.m., in the Commission's Courtroom, Second Floor, Tyler Building, 1300 East Main Street, Richmond,

Virginia, to receive comments from members of the public and to receive evidence in the above-captioned docket. Any person not participating as a respondent as provided for below may give oral testimony concerning this case as a public witness at the hearing. Public witnesses desiring to make statements at the public hearing need only appear in the Commission's Second Floor courtroom in the Tyler Building at the address set forth above prior to 9:45 a.m. on the day of the hearing and register a request to speak with the Commission's bailiff.

(4) Any interested person may participate as a respondent in this proceeding by filing, on or before September 26, 2007, an original and fifteen (15) copies of a notice of participation with the Clerk at the address in Ordering Paragraph (7), and shall simultaneously serve a copy of the notice of participation on counsel to Appalachian at the address in Ordering Paragraph (2).

Pursuant to Rule 5 VAC 5-20-80 of the Commission's Rules of Practice and Procedure, any notice of participation shall set forth: (i) a precise statement of the interest of the respondent; (ii) a statement of the specific action sought to the extent then known; and (iii) the factual and legal basis for the action. Interested parties shall refer in all of their filed papers to Case No. PUE-2007-00068.

(5) Within five (5) business days of receipt of a notice of participation as a respondent, the Company shall serve upon each respondent a copy of this Order for Notice and Hearing, a copy of the Application, and all materials filed by the Company with the Commission, unless these materials have already been provided to the respondent.

(6) On or before December 10, 2007, each respondent may file with the Clerk an original and fifteen (15) copies of any testimony and exhibits by which it expects to establish its case and shall serve copies of the testimony and exhibits on counsel to the Company and on all other respondents. The respondent shall comply with the Commission's Rules of Practice and

Procedure, including: 5 VAC 5-20-140, *Filing and service*; 5 VAC 5-20-150, *Copies and format*; and 5 VAC 5-20-240, *Prepared testimony and exhibits*.

(7) On or before February 6, 2008, any interested person may file with the Clerk, State Corporation Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia 23218-2118, written comments on the Application and shall simultaneously serve a copy on counsel to Appalachian at the address in Ordering Paragraph (3). On or before February 6, 2008, any interested person desiring to submit comments electronically may do so by following the instructions found on the Commission's website: <http://www.scc.virginia.gov/caseinfo.htm>.

(8) The Commission Staff shall investigate the Application. On or before January 18, 2008, the Staff shall file with the Clerk of the Commission an original and fifteen (15) copies of the Staff's testimony and exhibits and shall serve a copy on counsel to the Company and all respondents.

(9) On or before January 29, 2008, Appalachian shall file with the Clerk of the Commission an original and fifteen (15) copies of any rebuttal testimony and exhibits and shall serve a copy on the Staff and all respondents.

(10) On or before September 5, 2007, Appalachian shall cause the following notice to be published as display advertising (not classified) in newspapers of general circulation throughout the Company's service territory within the Commonwealth of Virginia in the following form:

NOTICE TO THE PUBLIC OF
APPALACHIAN POWER COMPANY'S
APPLICATION FOR A RATE ADJUSTMENT
PURSUANT TO VIRGINIA CODE § 56-585.5 A 6
CASE NO. PUE-2007-00068

On July 16, 2007, Appalachian Power Company
("Appalachian" or "Company") filed with the State Corporation
Commission ("Commission") an application seeking approval of a
rate adjustment clause ("Application") for recovery of costs the

Company proposes to incur in conjunction with its planned construction of an Integrated Gasification Combined Cycle ("IGCC") electric generating facility to be sited in Mason County, West Virginia, adjacent to Appalachian's Mountaineer Generating Station.

The projected cost of this IGCC facility is \$2.23 billion, of which approximately \$1 billion is proposed to be allocated to Appalachian's Virginia customers. The investment will increase the net book value of Appalachian's utility assets by more than 55 percent, from approximately \$3.8 billion to nearly \$6.0 billion. The principal relief sought in this Application is Commission approval of the rate adjustment clause requested by the Company, and a Commission determination that "construction of the IGCC facility is reasonable and prudent."

The Company cites subdivision A 6 of Virginia Code § 56-585.1, enacted by the 2007 Session of the Virginia General Assembly, as authority for the proposed rate adjustment clause. This new statute permits utilities such as Appalachian to request recovery, in conjunction with the construction of coal-fueled electric generating facilities, of the financial carrying costs of projected construction work in progress ("CWIP") together with an allowance for funds used during construction prior to the commercial operation date of such facilities through a rate adjustment clause.

Specifically according to testimony submitted in support of the Application, the rate surcharge proposed in this Application is designed to collect "IGCC financial carrying charges incurred and deferred between July 1, 2007 and December 31, 2008." Additionally, the Company is seeking in this proceeding to establish a rate surcharge collecting "IGCC carrying costs for the year 2009 as they are incurred by the Company." In sum, the Company is seeking to establish this surcharge based upon carrying charges estimated for the 30-month period beginning July 1, 2007, through December 31, 2009.

The Company estimates that its Virginia customers' allocated share of the financial carrying charges associated with the IGCC plant's construction expenditures for the 30-month period commencing July 1, 2007, and ending December 31, 2009, will approximate \$45 million. Appalachian has proposed to recover this sum in calendar year 2009, by instituting an IGCC surcharge ("IGCCS") factor to be applied to customers' bills starting on January 1, 2009.

The IGCCS factor proposed for this period is 10.7078%, to be multiplied against the generation portion of Appalachian's Virginia retail customers' electric bills. According to the Company, this is estimated to result in a total bill increase of 4.8% (utilizing 2007 as a base) for Appalachian's Virginia customers in 2009. The Company further estimates that the IGCCS factor will increase through the first year of the proposed plant's operation (projected in the Application as 2012), such that the total bill increase at that time is estimated to be 13.3% (utilizing 2007 as a base).

The Company's Application is docketed and assigned Case No. PUE-2007-00068. Interested persons may review a copy of the Application and the Commission's Order for Notice and Hearing in the Commission's Document Control Center, located on the First Floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia between the hours of 8:15 a.m. and 5:00 p.m., Monday through Friday. A copy of the Application may also be obtained at no cost by interested persons by making a written request to the Company's counsel, Anthony Gambardella, Esquire, Woods Rogers PLC, 823 East Main Street, Suite 1200, Richmond, Virginia 23219. If acceptable to the requesting party, the Company may provide the Application, with or without attachments, by electronic means. In addition, the Commission's Order For Notice and Hearing and other orders entered in this docket, the Commission's Rules of Practice and Procedure, as well as other information Concerning the Commission and the statutes it administers, may be viewed on the Commission's website at <http://www.scc.virginia.gov>.

As a preliminary matter, the Commission has directed the Company to (i) supplement its application to the extent necessary to enable the Commission to carry out its authority to review costs the Company proposes to incur in connection with this project under § 56-234.3 of the Code, or (ii) file a memorandum explaining why the Company does not believe such supplementation is needed. Section 56-234.3 of the Code requires the Commission to find that generation facilities proposed for construction are "necessary to enable the public utility to furnish reasonably adequate service and facilities at reasonable and just rates." The supplement or memorandum is to be filed with the Clerk of the Commission on or before September 5, 2007. If the Company files a memorandum in lieu of a supplement to its application, interested parties may file responses to the memorandum on or before September 26, 2007. The Company is

permitted to file a reply to these responses on or before October 3, 2007.

A public hearing will be convened on February 12, 2008, at 10:00 a.m., in the Commission's Courtroom, Second Floor, Tyler Building, 1300 East Main Street, Richmond, Virginia, to receive comments from members of the public and to receive evidence in the above-referenced docket. Any person not participating as a respondent as provided for below may give oral testimony concerning this case as a public witness at the hearing.

Public witnesses desiring to make statements at the public hearing need only appear in the Commission's Second Floor courtroom in the Tyler Building at the address set forth above prior to 9:45 a.m. on the day of the hearing and register a request to speak with the Commission's bailiff.

Any interested person may participate as a respondent in this proceeding by filing, on or before September 26, 2007, an original and fifteen (15) copies of a notice of participation with the Clerk, State Corporation Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia 23218-2118, and shall simultaneously serve a copy of the notice of participation on counsel to Appalachian at the address above. Pursuant to Rule 5 VAC 5-20-80 of the Commission's Rules of Practice and Procedure, any notice of participation shall set forth: (i) a precise statement of the interest of the respondent; (ii) a statement of the specific action sought to the extent then known; and (iii) the factual and legal basis for the action. Interested parties shall refer in all of their filed papers to Case No. PUE-2007-00068.

On or before December 10, 2007, each respondent may file with the Clerk of the Commission at the address above an original and fifteen (15) copies of any testimony and exhibits by which it expects to establish its case and shall serve copies of the testimony and exhibits on counsel to the Company at the address above and on all other respondents. The respondent shall comply with the Commission's Rules of Practice and Procedure, including: 5 VAC 5-20-140, *Filing and service*; 5 VAC 5-20-150, *Copies and format*; and 5 VAC 5-20-240, *Prepared testimony and exhibits*.

On or before February 6, 2008, any interested person may file with the Clerk of the Commission, at the address set forth above, written comments on the Application and shall simultaneously serve a copy on counsel to Appalachian at the address above. On or before February 6, 2008, any interested

person desiring to submit comments electronically may do so by following the instructions found on the Commission's website: <http://www.scc.virginia.gov/caseinfo.htm>.

APPALACHIAN POWER COMPANY

(11) On or before September 5, 2007, Appalachian shall forthwith serve a copy of its Application and this Order for Notice and Hearing on the Chairman of the Board of Supervisors and county attorney of each county and on the Mayor or Manager of every city and town (or on equivalent officials in counties, towns, and cities having alternate forms of government) in which Appalachian provides service. Service shall be made by personal delivery or by first-class mail, postage prepaid, to the customary place of business or residence of the person served.

(12) On or before September 26, 2007, Appalachian shall file with the Clerk of the Commission proof of the notice and service required in Ordering Paragraphs (10) and (11).

(13) The Commission's Rules of Practice and Procedure, 5 VAC 5-20-260, *Interrogatories to parties or requests for production of documents and things*, shall be modified for this proceeding as follows: (i) answers shall be served within fourteen (14) calendar days after receipt of interrogatories or requests for production of documents; (ii) objections shall be served within seven (7) calendar days after receipt of interrogatories or requests for production of documents; and (iii) motions on the validity of any objections shall be filed within ten (10) calendar days of receipt of any objection.

(14) As provided by § 12.1-31 of the Code of Virginia and the Commission's Rules of Practice and Procedure, 5 VAC 5-20-120, *Procedure before hearing examiners*, a hearing examiner is appointed to address issues that may arise relating to discovery in this docket.

(15) This matter is continued pending further order of the Commission.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:

Anthony Gambardella, Esquire, Woods Rogers P.L.C., 823 East Main Street, Suite 1200,
Richmond, Virginia 23219; C. Meade Browder, Jr., Senior Assistant Attorney General, Division
of Consumer Counsel, Office of Attorney General, 900 East Main Street, 2nd Floor, Richmond,
Virginia 23219; and the Commission's Office of General Counsel and Divisions of Energy
Regulation, Public Utility Accounting, and Economics and Finance.